Personal Financial Management - Lesson 4
Credit Buying

ENABLING OBJECTIVES:

Upon completion of this lesson, students will be able to:

4.1 Explain the basic uses of credit
- 4.1.1 Explain advantages and disadvantages of short-term loans
- 4.1.2 Explain advantages and disadvantages of long-term loans
- 4.1.3 Explain advantages and disadvantages of the use of credit
- 4.1.4 Explain advantages and disadvantages of the use of credit cards
- 4.1.5 Explain the down side of using high interest loans
- 4.1.6 Identify three factors affecting the cost of credit

4.2 List two appropriate and two inappropriate uses of credit

4.3 Calculate their debt-to-income ratios

4.4 Explain three warning signs of too much debt

4.5 Identify the purpose of a credit report and how to obtain one
- 4.5.1 Identify the components of a credit report
- 4.5.2 Explain how a credit report affects their ability to get credit
- 4.5.3 Explain how to obtain a credit report

4.6 Identify three sources of help in answering questions about credit and managing personal indebtedness

REFERENCES:

1. OPNAVINST 1740.5A (Draft)
2. U.S. Navy's Personal Financial Management Standardized Curriculum (PERS 662)
3. OPNAVINST 1740.1 Fleet and Family Support Center
4. Command Financial Specialist Training Manual NAVPERS 15608C
5. www.lifelines2000.org
6. www.moneycentral.msn.com
7. Navy Legal Services Office
8. UCMJ Articles 123a and 134
9. http://www.a-home-mortgage-credit-card-debt-loan.com/

SHOW SLIDES:

4-1	Lesson 4 Title Slide
4-2	Credit Card Facts
4-3	Credit Example
4-4	Short-term Loans
4-5	Long-term Loans
4-6	How Creditworthy Are You?
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4-8	Capacity
4-9	Collateral
4-10	Appropriate Uses of Credit
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4-12	Motivations to Abuse Credit
4-13	Debt-to-Income Ratio
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4-18	Credit Reports
4-19	Credit Bureaus
4-20	Report Contents
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4-22	Ensuring Accurate Reports
4-23	Consumer Credit Protection Laws
4-24	Dealing With Creditors
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4-27	Summary Questions
4-28	Summary
4-29	Effect of Compound Interest

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CASE STUDIES:
None

VIDEO TAPES:
None

NOTES TO THE FACILITATOR:
The main points of this topic are:

- $ How to Use Credit
- $ Appropriate and inappropriate uses for credit
- $ The effect of Debt-to-Income ratio on receiving credit
- $ Warning Signs of Too Much Credit
- $ Anatomy of a Credit Report
- $ How Your Credit Report Affects Your Entire Financial Life
- $ How To Get A Copy
- $ How to Dispute/Correct/Cure
- $ Where to get help

I. INTRODUCTION During this hour we will discuss types of credit, appropriate uses of credit, how to tell if you have too much debt, and what a credit report is and how it will affect you all of your life.

SHOW SLIDE 4-1 INTRODUCTION

Note to facilitator
Ask the following questions:
1. How many of you have credit cards?
2. How many of you use those credit cards?
3. How many of you pay off your whole bill every month?

II. CREDIT CARD FACTS

SHOW SLIDE 4-2 CREDIT CARD FACTS

A. VISA International has determined that just placing a credit card in someone's hand will cause an increase in spending of 32%.

B. The average American family has 9 credit cards (1996 American Express survey).

C. Three or four of those are used regularly; the average total balance on those cards is $8,000, at an interest rate of 18%.

D. Nearly half of all credit card holders—43%—make only the minimum required monthly payments at least part of the time. (This number has been on the rise in recent years. Incidentally, the percentage of smart consumers who pay their credit card bills in full each month has also increased, from 29% in 1990 to 36% in 1996.)

E. Over 19% of Americans' monthly income is now eaten up by debt payments.

F. For example, if you charge $500 at 24% and make only the 2% minimum monthly payment, it will take you 30 years to pay off this charge, and you will have paid $3,610.00 in interest over and above the $500 for your purchases.

SHOW SLIDE 4-3 CREDIT EXAMPLE

III. SHORT-TERM VERSUS LONG-TERM LOANS

SHOW SLIDE 4-4 SHORT-TERM LOANS

To use credit to your advantage, you should understand the differences between short-term and long-term loans, so let's examine the advantages and disadvantages of each. Incidentally, the terms "short-term" and "long-term" are relative, not associated with any particular time period.

A. Short-term Loans. Short-term loans usually offer a better interest rate than longer-term loans. In addition, even if rates are the same, the shorter term loan will save you money in interest over a longer loan. Their down side is higher monthly payments.

SHOW SLIDE 4-5 LONG-TERM LOANS

B. Long-term Loans. The primary advantage of a long-term loan is that it lowers your monthly payments. Disadvantages are an increase in the amount of interest paid, and the fact that some items purchased with long-term loans may wear out before the debt is retired.

IV. HOW CREDITWORTHY ARE YOU? Before deciding whether or not to grant you a loan, or other types of credit, and at what interest rate, a financial institution or company will evaluate the probability that you will make required payments on time. These three factors weigh heavily in those decisions.

SHOW SLIDE 4-6 HOW CREDITWORTHY ARE YOU?

A. Character. Do you have a history of repaying loans on time? Credit references that appear on credit reports are used. These include bankcards (the single best reference), travel and entertainment cards, department store cards, mortgages, and auto loans. Stability (length of time on the job and in a location), age, and checking and savings account records are also taken into account. If you have bounced checks or been late on rent, or not paid some bills, they will appear on your credit history and will prevent you from getting credit.

SHOW SLIDE 4-7 CHARACTER

B. Capacity. How likely is it you can repay the loan on time? Income, how much potential credit you hold (number of cards, number of inquiries), and total debt levels are considered.

SHOW SLIDE 4-8 CAPACITY

C. Collateral. What, if any, additional security is there to ensure the loan will be repaid? Collateral is normally required for any large loan, such as for a home or a car.

SHOW SLIDE 4-9 COLLATERAL

V. APPROPRIATE AND INAPPROPRIATE USES OF CREDIT There are times when it makes sense to use credit, and many times when it does not.

SHOW SLIDE 4-10 APPROPRIATE USES OF CREDIT

A. Appropriate uses for credit. The best use of credit is to purchase assets – things that will grow or increase in value over time, like your own business or buying a home or a rental property. Credit is also useful for convenience – avoiding having to carry large sums of cash or as a management tool. Wise use of credit virtually always falls into one of these two categories – assets or convenience. Sometimes use of credit for major consumer goods (so-called "big ticket" items) cannot be avoided; few of us can purchase our first car without a loan. This, too, is an acceptable use of credit.

B. Inappropriate uses of credit. Credit becomes more dangerous when used to purchase consumables. Furniture, clothing, sporting equipment, meals out, and vacations lose much or all of their value immediately after purchase. Such unwise use of credit is often motivated by one of four factors.

SHOW SLIDE 4-11 INAPPROPRIATE USES OF CREDIT

VI. MOTIVATIONS TO ABUSE CREDIT

SHOW SLIDE 4-12 MOTIVATIONS TO ABUSE CREDIT

A. Availability of credit can lead to a "buy now, pay later" mentality. Impulse buying on credit can result in your purchasing an item you would never have bought if you had to pay cash. Additionally, you may pay up to 33% more for the item than if you had shopped around at discount locations or on the internet.

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B. Spending on credit to impress others is another common trap. Advertisements that show people using a credit card to treat their friends can tempt you to make these unwise choices. Remember that who you are and what you have done say far more about you than what you own or the number of credit cards in your wallet or purse.

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C. Lack of, or failure to adhere to, an agreed-upon family spending plan is another cause for unwise use of credit. A violation of the plan by one member can result in unwise spending by the other just to "even the score."

D. Believe it or not, spending to feel good can become an addictive behavior. Like other addictions, the aftereffects take their toll long after the good feeling has faded. Avoid this trap by asking yourself if you really need, and can afford to pay for, an item before you charge it.

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VII. DEBT-TO-INCOME RATIO You should recall from our spending plan exercise that your debt-to-income ratio is simply the amount of your monthly debt payments, not including mortgage payments, divided by your monthly income, times one hundred. You should also recall that the guidelines shown here should serve as a guide to the wise use of credit. Re-compute your debt-to-income ratio each month. Facing the reality that you are approaching or above the recognized danger level for debt may serve as an additional deterrent to unwise use of additional credit.

SHOW SLIDE 4-13 DEBT-TO-INCOME RATIO

VIII. WARNING SIGNS OF TOO MUCH DEBT There are several warning signs, in addition to your debt-to-income ratio, that you are on the high-speed highway to financial ruin.

SHOW SLIDE 4-14 WARNING SIGNS OF TOO MUCH DEBT

A. Those of you who face reality will have plenty of warning that your debt load is getting out of control, starting with not paying off most of your cards every month. You should become concerned if higher and higher percentages of each month's pay goes to service your debt. When you start to fall behind on payments, and/or need loans or cash advances for daily living expenses, it's time to seek help - fast!

SHOW SLIDE 4-15 DEBT WARNING SIGNS

B. Additional clues that all is not right in your financial world include not having at least one month's pay in a savings account, being at or near the limit on all your credit cards, or relying on a second job or spouse's income to make ends meet. Remember that outside income and your spouse's employment can be affected by an extended deployment or Permanent Change of Station.

SHOW SLIDE 4-16 MORE WARNING SIGNS

C. You should acknowledge that things are critical when you start skipping some bill payments, using credit to pay credit, using or even considering a debt consolidation loan, being denied additional credit, or hiding bills and lying to members of your family.

SHOW SLIDE 4-17 INDICATIONS OF SERIOUS PROBLEMS

IX. CREDIT REPORTS A credit report is simply a centrally maintained report of your complete credit history. Each of you probably already has, or soon will have, at least one credit report. Your credit reports will follow you throughout your life. A good report can open many doors for you, and a bad report will be a real drag on your future plans and aspirations. So let's look at who keeps these reports, what they contain, how they are used, and what you should do to ensure your report is accurate.

SHOW SLIDE 4-18 CREDIT REPORTS

A. Credit Bureaus. Most credit reports are compiled by the three major companies shown here. A list of these companies and contact information is provided in your handout. They sell the reports to creditors, they rent or sell lists from the data in the reports, and they charge a fee ($8 to $10) for getting a copy yourself, unless it was the reason that you were denied credit, then it is FREE if you ask within the time limit set by law. These companies are competitors, so they do not share their information, and therefore, the information in your report with each of them may be different.

SHOW SLIDE 4-19 CREDIT BUREAUS

NOTE TO FACILITATOR

Inform students that credit agencies' addresses and phone numbers are provided in the student handouts.

B. Components. Your credit report has four major components.

SHOW SLIDE 4-20 REPORT COMPONENTS

1. Personal Information - You usually provide this when you fill out an application for credit. What is not already in your file gets added when you volunteer it in this process. You might not want a great deal of personal information to go on file, however, if you refuse to provide it the creditor can deny you credit.

2. Credit History - This is the section with the so-called trade lines. It contains the history of all your accounts of which they have information. It shows all of your credit information: the type of account, the date it was open, your payment history, and the current status of the account. This information is used in evaluation of your creditworthiness. This section will contain your history of late or missed payments – definite adverse entries.

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You should ensure all closed accounts are reflected as such because potential credit, as well as actual debts, may be used by the lender to compute your debt-to-income ratio. Be sure the report shows that such accounts were closed at your request; otherwise it is left open to question that it might have been closed for cause, more potential adverse information.

3. Public records - This section will contain any judgments that have been entered against you. Judgments against include divorce if you were the respondent. Even though this is not really a judgment against in the usual sense, it can be cause for denial of credit. Usually this reason will be justly invalidated if it is the sole reason for denial. Other judgments such as foreclosure, bankruptcy, criminal convictions, and even some driving infractions can be devastating to your credit rating.

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4. Inquiries - This section contains a record of all who have requested and been provided with copies of your report. It is especially useful if correcting erroneous information – the credit bureau is required by law to provide corrections to all who received your report within the past six months.

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C. Uses. Potential employers may access your credit report as a character check. But by far the most common use is by potential landlords, mortgage companies, banks and other lending institutions, and merchants offering charge accounts and credit cards to determine how creditworthy you are. Your credit report is accepted as a factual accurate reflection of your credit history and your ability and commitment to meet financial obligations. It is the single most influential item affecting your access to credit. Some potential creditors make subjective judgments based on the totality of the report, but many rely on a largely automated credit scoring system. Adverse information such as bankruptcy, foreclosure, garnishments, repossessions, referrals to collection agencies, and late or missed payments is always a killer.

SHOW SLIDE 4-21 HOW CREDIT REPORTS ARE USED

D. Ensuring Accurate Reports. Approximately 20% of all credit reports contain inaccurate information. It's up to you to ensure erroneous information is corrected or your version is included in your file.

SHOW SLIDE 4-22 ENSURING ACCURATE REPORTS

1. Get Copies - The first step you must take is to get copies of all your credit reports. If you were denied credit, your copy will be free. Names, addresses and phone numbers of the major bureaus are in your handout.

2. Disputed Items - If you dispute an item on your report, by law the credit bureau must investigate it, and if it is found to be incorrect, they must correct it. If they do not complete the investigation within 30 days, they must drop the disputed item from your report.

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3. Your version - If the credit bureau refuses to correct the disputed information, you have the right to have a statement of your version of the disputed information included in your report, and the credit bureau must send a copy of it to anyone who received a copy of your report in the past 6 months. If the information is confirmed, however, it becomes very difficult to remove; there are no quick "fixes" available for a bad credit record.

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X. YOUR CREDIT RIGHTS When you are being denied credit you should be familiar with the Consumer Credit Protection Laws.

SHOW SLIDE 4-23 CONSUMER CREDIT PROTECTION LAWS

A. Truth In Lending Act. The Truth In Lending Act of 1968 and amendments ensure customers are given information about the cost of the credit for which they are applying. Lenders must disclose the cost of any loan expressed both as the annual percentage rate of interest and as the total finance charge in dollars. It applies to single purchases made on credit as well as purchases by credit cards. Additionally, the Act provides three business days in which you may cancel a transaction that used your home as security or that took place at your residence (door-to-door sales). You must do this in writing. This does not apply to all purchases, for example, there is no cooling off period on car purchases. This law also limits your liability for lost or stolen credit cards to $50 per account, if you notify the issuing company. Contact them immediately and follow up in writing.

B. Fair Credit Billing Act. This act protects you from billing errors and allows you to dispute charges in writing within 60 days. You may also withhold payment for items purchased on your credit card which do not meet the quality standards the seller promised if your good faith try to remedy with the seller fails. Not applicable to credit card purchases made overseas. You should review your statement each month to be sure you recognize all charges.

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C. Fair Credit Reporting Act. This act provides for your right to know what is on your credit record and provides for the dispute and deletion of inaccurate information. The credit bureau must first request confirmation from the business that originally made the disputed entry; if unable to get confirmation, the information is supposed to be removed, since the consumer has the benefit of doubt. This act allows you a free credit report if denied credit and limits the time information stays on your credit file.

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D. Fair Debt Collection Practices Act. This act determines the means by which debt collectors can contact you. You are protected from unfair practices from third party debt collectors. They cannot be abusive, harass you, tell anyone else about your debt, or threaten you. You can write to debt collectors and tell them to stop contacting you. You can also sue them for breaking this law.

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E. Equal Credit Opportunity Act. This act provides for granting of credit regardless of race, gender, marital status, age, religion, color, national origin or RECEIPT OF PUBLIC ASSISTANCE.

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F. Fair Credit and Charge Card Disclosure Act. This act requires that credit cards solicitations inform you of their total cost. This includes APR, grace period, annual fee, finance charge, other fees, and the method for calculating the balance.

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G. State Protection. Federal laws do not regulate interest lenders may charge you! Some states may provide additional protection in credit matters; however, many have few credit or consumer protection laws. In particular, in some states there is no effective cap on interest rates.

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NOTE TO FACILITATORS

Research the laws of your particular area and provide that information here. This information is crucial to all audiences.

XI. DEALING WITH CREDITORS Even though you may have legal protections as just discussed, there are right ways and wrong ways to deal with creditors if you find yourself in financial difficulty.

SHOW SLIDE 4-24 DEALING WITH CREDITORS

A. Here are some positive actions you should take.

1. Stay in contact with your creditors; let them know if there is a problem. If a friend owed you money and was avoiding you or not returning phone calls, you would think he or she was trying to "stiff " you. Businesses are the same way. Just talk to them.

2. Be honest.

3. Approach them with a plan, but be careful of promising more than you can deliver.

B. Conversely, there are some things your should not consider.

SHOW SLIDE 4-25 THINGS NOT TO DO

1. Credit clinics. Many of these charge up-front fees promising to "clean up your credit report" fast and get you out of debt. They cannot do anything for you that you cannot do for yourself. Charging up front fees for debt counseling is illegal in a number of states.

2. Debt consolidation loans. Debt consolidation loans are not always bad, but they are at best a temporary fix. They will not work without a change in your behavior. A 1996 study by American Express indicated 78% of all consumers who take out bill consolidation loans have a higher debt-to-income ratio 18 months later than when they first took out the loan. **CLICK FOR BULLET**

3. Bankruptcy. Declaring bankruptcy does not allow you to walk away from all past problems. This is a last resort option that may have lasting consequences. It may severely impact on your ability to get credit in the future, in addition to the potentially negative career implications. **CLICK FOR BULLET**

4. Pawn Shops. **CLICK FOR BULLET**

5. Payday Loans. **CLICK FOR BULLET**

XII. SOURCES OF HELP Particularly as a member of the military, there are several sources you can turn to for assistance in properly managing credit or recovering from failure to do so.

SHOW SLIDE 4-26 SOURCES OF HELP

A. Your Command Financial Specialist is always a good place to start.

B. Fleet and Family Support Centers. Your local FFSC will have a Financial Educator and/or a CFS on staff to provide personal financial information and counseling. They normally work closely with the CFS at the local commands.

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C. Navy Legal Services can provide assistance in a dispute over a bill or contract. They strongly encourage service members to come in with a copy of the contract before signing it when making any major purchase.

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D. Local Defense Credit Unions often have financial counselors available who provide a range of services to members, up to and including full-scale debt management programs.

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E. Consumer Credit Counseling Services (CCCS) provides low- or no-cost financial counseling and debt management.

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F. Navy-Marine Corps Relief Society provides no-cost financial counseling and emergency financial assistance.

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SHOW SLIDE 4-27 SUMMARY QUESTIONS

Summary Questions

1. What are two advantages of short-term loans?
2. What are two disadvantages of short-term loans?
3. What are two advantages on long-term loans?
4. What are two disadvantages of long-term loans?
5. What are two inappropriate uses of credit?
6. How and where can we obtain a credit report?
7. Where are three places we can go for help?

III. SUMMARY Credit is something you will use throughout your lifetime. It can be a valuable tool; however, it can also be a source of long lasting difficulty. The availability and over extension of credit has contributed significantly to the rise in personal bankruptcy rates in the past 20 years. Wise use of credit can be a key element in achieving financial independence; misuse can be a ticket to financial ruin. It is your decision. To help you make wise credit decisions, we have discussed factors that affect the cost of credit, appropriate and inappropriate uses of credit, and warning signs of too much credit. We also talked about what credit reports are and what you should do to ensure yours is accurate and reflects favorably on your ability to manage your finances. Lastly we identified sources of help should you encounter problems properly using credit.

SHOW SLIDE 4-28 SUMMARY

SHOW SLIDE 4-29 EFFECTS OF COMPOUND INTEREST